EXHIBIT A

In The
UNITED STATES DISTRICT COURT
For The Eastern District Of Virginia
Richmond Division

Civil Action
No. 74-0013-R

Edwin R. MacKethan, Receiver
Norfolk Savings & Loan Corp.

v.

Commonwealth Of Virginia, et al

MEMORANDUM

Filed July 24 1974

This matter is before the Court on the motion of the defendant, the Commonwealth of Virginia [hereinafter referred to as the State], to dismiss the complaint filed herein as to it. Similar motions by other of the defendants which are now pending, and some of which are still awaiting plaintiff's response, will not be considered herein.

Plaintiff, Edwin R. MacKethan, is the Receiver of the Norfolk Savings and Loan Corporation, having been so appointed by the Law and Chancery Court of the City of Norfolk, Virginia, in a suit there pending between the Commonwealth of Virginia at the relation of the State Corporation Commission of that State and the Norfolk

Savings and Loan Corporation. As Receiver, plaintiff is the possessor of all claims of that corporation, its depositors, creditors and owners, and seeks here a judgment for damages against the various defendants in the amount of eleven million dollars.

As relates to its claim against the State, the plaintiff alleges generally that the State, through agents of its State Corporation Commission, negligently and/or fraudulently: one, breached its regulatory duties with respect to the activities of the now closed Norfolk Savings and Loan Corporation; and two, participated in the dissemination of false or misleading information to investors in said corporation by failing to disclose relevant information in its possession.

Jurisdiction is sought to be invoked pursuant to 15 U.S.C. § 78aa.

Prior to the filing of this action, the instant plaintiff had filed a related action in this Court naming the State as the sole defendant. *MacKethan* v. *Commonwealth of Virginia,* Civil Action No. 73-547-R. Subsequent to the filing of the present action, wherein additional defendants were joined, the Court dismissed the previous action on jurisdictional grounds. The Court there held that jurisdiction was lacking by reason of the State's sovereign immunity, inherent in the State and preserved to it by the Eleventh Amendment to the Constitution of the United States. See *MacKethan* v. *Commonwealth of Virginia,* C.A. No. 73-547-R, *mem. decis.* Jan. 16, 1974 (E.D.Va.)

The defendant's motion in this action likewise raises the bar of sovereign immunity as grounds for dismissal.

As to the first count in plaintiff's present complaint, it is obvious to the Court that said count must be dismissed for the reasons stated in the memorandum accompanying the

order dismissing the plaintiff's previous related action against the State. *MacKethan* v. *Commonwealth of Virginia,* C.A. No. 73-547-R, *mem. decis.,* Jan. 16, 1974 (E.D.Va.). That is because the first count in the present complaint simply incorporates by reference all of the allegations contained in the complaint filed in the previous action referred to.

The additional allegations in Counts II and IV of the present complaint relate essentially to claims brought against defendants other than the State in this action, and are therefore irrelevant to the motion presently before the Court.

As to the third count in the present complaint, which does attempt to raise a claim against the State, the plaintiff contends that same is a "new claim" and that the reasoning behind the decision in the previous action does not apply with respect to this "new claim." The plaintiff asserts that the "new claim" in Count III, unlike the claim previously asserted, fails within an exception to the bar of sovereign immunity.

I.

RES JUDICATA

To be more specific, the plaintiff contends that the claim raised in the previous action and incorporated into Count I of this action, was premised on a theory that the State had breached its state statutory duty of supervising the aforementioned savings and loan corporation's securities transactions and was therefore liable for the resultant damages to depositors, creditors and owners. The plaintiff argues, however, that the claim raised in Count III of the instant complaint is based on the state's alleged complicity in the dissemination of false or misleading information to investors in the aforementioned savings and loan corporation, in clear violation of federal securities laws.

The Court would begin by pointing out that it did not construe the plaintiff's previous action as having been so narrowly drawn as plaintiff now suggests.[1] In its memorandum dismissing the complaint therein the Court stated at one point:

> . . . Indeed plaintiff alleges that "the Commonwealth and the Board of Directors conspired to prevent the public from realizing the insolvent condition" of the corporation.
>
> It is these alleged acts of the defendant upon which plaintiff premises his claim under the Securities Act of 1933 and . . . the Securities Exchange Act of 1934 . . .

C.A. No. 73-547-R, *mem. decis.*, jan. 16, 1974, at p. 2 (E.D. Va.).

Indeed, had the Court viewed the previous claim as having been based solely on the defendant's alleged breach of its state statutory duties, it would never have reached the issue of sovereign immunity. Absent the element of an alleged federal securities violation, the plaintiff's claim would simply have amounted to a state claim. Under that circumstance, regardless of the state's alleged waiver of sovereign immunity, the Court would have been totally lacking subject matter jurisdiction, which is the first prere-

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[1] Courts, of course, decide cases on the basis of facts presented. While it is hoped that the litigants will aid the Court by drawing attention to the relevant principles of law, courts do not limit their inquiry, with regard to the applicable legal principles, to the arguments presented by the litigants.

Moreover, noting the various arguments which the plaintiff advanced in the previous action, the Court ascribes plaintiff's present suggestion that the prior complaint was as narrowly drafted as he now contends, to be no more than the exercise of a lawyer's prerogative not to necessarily accept his own arguments as being conclusive of any given issue,—in short, one does the best he can with what he has.

quisite to maintaining an action in federal court. See *Mansfield, Coldwater & Lake Ry.* v. *Swan,* 111 U.S. 379 (1884); *Minnesota* v. *Northern Securities Co.,* 194 U.S. 48, 62-63 (1904).

Beyond that, the Court would further note that the only apparent difference between the plaintiff's "old claim" and his "new claim" is in the theories on which they are premised. The factual allegations do not appear to differ materially. While a new hair-do may create a new woman, as certain advertisements suggest, a new legal theory does not make a new cause of action. *Moreno* v. *Marbil Productions, Inc.,* 296 F.2d 362 (5th Cir. 1961); *Norman Tobacco & Candy Co.* v. *Gillette Safety Razor Co.,* 295 F. 2d 362 (5th Cir. 1961). The doctrine of *res judicata* applies to jurisdictional issues, as well as to substantive matters. See *Stoll* v. *Gottlieb,* 305 U.S. 165, 172 (1938); *Baldwin* v. *Iowa State Traveling Men's Ass'n.,* 283 U.S. 522 (1931). Therefore, even assuming the Court had not given the previous complaint the full breadth of consideration justified by the allegations set forth therein, the present action would still be barred by the doctrine of *res judicata.* See, *id.* The plaintiff's only relief would be by way of appeal.

Finally, there is no doubt that the present action arises out of the same series of occurrences that was subject to controversy in the previous action. Assuming further that the plaintiff had come forward in the present complaint with *new* factual allegations bearing on the sovereign immunity question, the new action would still be barred under the doctrine of *res judicata.* This is because a plaintiff may not litigate his claim piecemeal. See *Heiser* v. *Woodruff,* 327 U.S. 726, 735 (1946), and cases cited therein. Repetition, whether in presenting new theory *or pleading additional facts,* is not to be tolerated. See *Lester* v. *National Broad-*

casting Co., 217 F. 2d 399 (9th Cir. 1955), *cert. denied*, 348 U.S. 954 (1955), *rehearing denied*, 349 U.S. 917 (1955). See also, *Kriesel* v. *Berkshire Associates, Inc.*, 452 F.2d 491 (4th Cir. 1971) (deciding the issue under Virginia law).

II.

SOVEREIGN IMMUNITY

The essence of plaintiff's contention in this regard, throughout this and the previous litigation, has been that the state had expressly or impliedly waived its sovereign immunity.

In the memorandum dismissing the previous complaint, the Court concluded that it could find no Congressional intent to pre-condition the State's entry into the field of securities *regulation* on the State's consent to be sued for claims arising out of that activity. *MacKethan* v. *Commonwealth of Virginia*, C.A. No. 73-547-R *mem. decis.* Jan. 16, 1974 (E.D. Va.). *Cf., Parden* v. *Terminal R. Co. of Alabama*, 377 U.S. 184, 187-191 (1964) with *Employees* v. *Missouri Public Health Dept.*, 411 U.S. 279, 287 (1973). Accordingly, no implied waiver was found.

The only theory not previously addressed is plaintiff's apparent contention that, by participating in the dissemination of false or misleading information, incidental to its regulatory action, the State agency involved left the sphere of legitimate governmental activities, and thereby became a mere "lawbreaker." The plaintiff argues that the State thereby "waived" its immunity for actions arising under the federal securities legislation.

This contention, in the Court's view, misconceives the doctrine of sovereign immunity. There is no issue but that action which violates superior federal law is outside the scope

of legitimate state activity, regardless of the state authority relied upon. *Ex parte Young,* 209 U.S. 123, 159-160, 163, 166-68 (1908). The state functionary involved is, in a sense, a law breaker. The theory is that although the state functionary may be acting under color of state law, his actions are not the official actions of the state. *Id.* It is basic that the simple act of violating superior federal law does not establish a waiver of sovereign immunity merely because the state, through its functionaries, has thereby left its legitimate sphere of activities.[2] See *Hans* v. *Louisiana,* 134 U.S. 1, 10 (1889); *Smith* v. *Reeves,* 178 U.S. 436, 446-49 (1900).

Moreover, the plaintiff's argument fails to distinguish this case from *Employees, supra,* 411 U.S. 279. There was no question in *Employees* that the state employer was covered by the substantive provisions of the Act there in question. 411 U.S. 282. On a motion to dismiss, the state employer in *Employees* was presumed to have been in violation of the standards set forth in that legislation. *Employees,* therefore, also involved a clear violation of superior federal law; but no waiver of sovereign immunity was found.

As to the question of Congressional intent, upon which the issue of an implied waiver of sovereign immunity ultimately turns, the Court recognizes that Section 2 of the Securities Act of 1933, 15 U.S.C. § 77(b)(2), defines a "person" to include "a government or political subdivision thereof;" and that Section 17 of the Act, 15 U.S.C. § 77(q), makes it unlawful for any "person" to fraudulently participate in the dissemination of false or misleading information with regard to the sale of securities. Even assuming arguendo that this

[2] Assuming, however, that the state functionaries involved had not been acting in good faith, it may be that they would be liable, in their individual capacities, for their participation in the alleged federal securities violation. *Cf. Pierson* v. *Ray,* 386 U.S. 547, at 555-557 (1967); *Monroe* v. *Pape,* 365 U.S. 167 (1961).

statutory scheme might properly be interpreted as establishing a Congressional intent to precondition direct participation by the various states in the marketing of securities on a waiver of sovereign immunity as to any violations of the Act that might occur in the process, see *Parden* v. *Terminal R. Co., supra,* 377 U.S. 184, 187-191;[3] plaintiff must still fail, for he has not alleged facts sufficient to establish direct state involvement, either as principal or agent, in the marketing of securities. The relevant state legislation provides for the regulation of savings and loan company activities, which may include supervision over the marketing of securities by such organizations. See Va. Code § 6.1-237, *et seq.,* Code of Virginia 1950. That legislation does not, however, contemplate *active* participation by the state in the process of marketing the securities. Any indirect involvement by the state in such activities would be merely incidental to the state's performance of its regulatory function. Under any interpretation of the federal securities legislation in question, the Court cannot conceive that Congress intended to precondition the state's engaging in a regulatory function, such as that here present, on a waiver of sovereign immunity as to any securities violations that might occur with regard to the activities of the regulated organizations.

To reiterate, the state's function here was regulatory, which is a purely governmental function. The implications of Congressional intent with regard to the coverage of the Securities Act of 1933 might be quite the opposite had the state here been a principal or participant in a proprietary

[3] The Court does not, however, here determine that such interpretation is necessarily appropriate. Further analysis might lead to the conclusion that even under this statutory scheme the remedies available against the states for violations of the Act are limited by the Eleventh Amendment to exclude private damages actions. See *Employers* v. *Missouri Public Health Dept., supra,* 411 U.S. 279, 285-86.

function which necessitated also its active participation in the public sale of securities to finance the venture.[4] *Cf. Parden* v. *Terminal R. Co., supra,* 377 U.S. 184, with *Employees* v. *Public Health Dept., supra,* 411 U.S. 279.

It may be, as alleged, that certain state functionaries participated directly with others in the dissemination of information which ultimately proved to be false or misleading. Were that participation in the public information activities of the savings and loan company officially sanctioned by the regulatory legislation under which the state functionaries had been acting, the argument for an implied waiver would unquestionably be stronger. In such a situation the official state involvement in the securities marketing activities would have to be viewed as more direct. However, the legislation here in question does not, on its face, contemplate even good faith participation by state functionaries in the dissemination of corporate financial information to the investing public. See Va. Code, § 6.1-237, *et seq.* Therefore, any such participation which may in fact have occurred would have been ultra vires in its inception, and cannot be viewed as a waiver, by the state, of its sovereign immunity.

Finally, the Court takes note of the plaintiff's objection that the issue of sovereign immunity is not ripe for determination on a motion to dismiss. Suffice it to point out that, regardless of what the evidence may show as to the unofficial activities of the state functionaries involved in this matter, no proof of facts can change the purely regulatory nature of the legislation under which they were acting. In the absence of more, no implied waiver of sovereign immunity can be found; and no express waiver is apparent.

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[4] It is not uncommon for municipal corporations and other governmental subdivisions to join with private enterprise in the marketing of securities to finance, for example, industrial parks.

For the reasons stated, the state's motion to dismiss will be granted, and the action will be dismissed as to the state.

An appropriate order shall issue.

/s/ ROBT. R. MERHIGE, JR.
United States District Judge

Date: JUL 24 1974